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## DEFENSE OUTSOURCING

### Challenges Facing DOD as It Attempts to Save Billions in Infrastructure Costs

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### Mr. Chairman and Members of the Committee

I am pleased to be here today to present our observations, based on past and ongoing work, on the Department of Defense's (DOD) goal to save billions of dollars by outsourcing work to the private sector and through other initiatives. For fiscal year 1997, DOD estimates that about \$146 billion, or almost two thirds of its budget, will be for operations and support activities. These activities, which DOD generally refers to as its support infrastructure, include maintaining installation facilities, providing nonunit training to the force, providing health care to military personnel and their families, repairing equipment, and buying and managing spare parts inventories. As you requested, I will discuss DOD's past experience in achieving infrastructure savings, key infrastructure areas that offer the greatest potential for savings, and challenges DOD faces in reaching goals to reduce infrastructure in the future.

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## Background

DOD defines infrastructure as activities that generally operate from fixed locations to support missions like those carried out by combat forces. Infrastructure includes installation support; central training; central medical; central logistics; force management; acquisition; infrastructure; central personnel; and central command, control, and communications. DOD recognizes that its support structure is inefficient and that its costs continue to absorb a large share of the defense budget and diverts funding that could be used for modernization.

DOD has implemented various reform initiatives in the past to achieve efficiencies and reduce costs. The Defense Management Review (DMR), base realignment and closure (BRAC) process, National Performance Review, the bottom-up review, and other efforts proposed various actions intended to achieve these objectives. More recently, the Commission on Roles and Missions (CORM) and the Defense Science Board (DSB) have identified similar problems with DOD's support structure and processes, but have made outsourcing and privatization the centerpiece of their reforms to reduce infrastructure and support costs. DOD defines outsourcing as the transfer of functions performed inhouse to outside providers and privatization as the transfer or sale of government assets to the private sector.

Between fiscal year 1997 and 2002, DOD plans to increase procurement funding from \$44.1 billion to \$68.3 billion, primarily to buy new weapon systems and upgrade existing systems. DOD hopes that initiatives to reduce

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infrastructure costs will provide much of the increased procurement funding. Initiatives to achieve infrastructure and support savings include outsourcing and privatization, acquisition reforms, organizational streamlining and consolidation, management process reengineering, base and facility closures, personnel reductions, and inventory reductions. DOD's quadrennial review is likely to identify additional plans and initiatives for reducing infrastructure costs. If savings from these initiatives are not achieved and the defense budget remains relatively constant, planned weapon systems procurements may have to be delayed, stretched out, or canceled; the force structure may have to be further reduced; and/or compromises may have to be made in military readiness.

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## Results in Brief

Before providing the details of my statement, I would like to briefly summarize the key points. First, we fully agree with DOD and others such as the CORM and the DSB, that significant opportunities exist to reduce DOD's infrastructure and support costs. We also agree that many of the initiatives that have been proposed relating to outsourcing represent real opportunities for helping to achieve these savings. However, we question whether the magnitude of savings anticipated by DOD and others is attainable within the current strategy and force structure. To the extent that these savings are not achieved, DOD and the Congress may have to deal with difficult decisions about how to fund the needed modernization of weapon systems and other DOD priorities.

Specifically, our past and ongoing work relative to DOD's savings initiatives shows that while past savings initiatives yielded significant savings, they often fall short of DOD's initial goal. For example, the DMR initiatives did not achieve the level of savings that were originally estimated and many of the initiatives proposed were not accomplished. For example, although DOD-wide efforts to standardize and consolidate automatic data processing systems under the Corporate Information Management initiatives estimated savings of \$2.18 billion during 1991 through 1995, these savings were never realized and the program has largely been abandoned. Likewise, most of the \$5.6 billion savings projected for consolidation initiatives have not materialized. Further, while DOD has substantially reduced its infrastructure through the BRAC process and significant savings will ultimately be achieved, savings will not be as great as initially estimated or achieved as quickly as initially hoped. Also, efforts to outsource various commercial activities under Office of Management and Budget (OMB) Circular A-76, yielded some savings, but again the savings were often less than anticipated. In the final analysis, today's future years

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defense plan shows that, despite these initiatives, future infrastructure costs will only slightly decline as a relative percentage of DOD's budget.

Because of our concern about the waste and inefficiencies in DOD's support structure and operations, we have designated DOD's infrastructure as 1 of 24 high-risk areas that is vulnerable to waste and mismanagement within the federal government. We believe that DOD could reap significant savings by: (1) reducing excess capacity in its testing and evaluation areas and reducing the 35-percent excess capacity in DOD's laboratories and centers; (2) reducing the 50-percent excess capacity within DOD's depot maintenance system; (3) reducing the costs of managing its \$67 billion inventory, of which almost half is beyond war reserve and operating requirements, by aggressively adopting leading edge best practices; (4) reducing installation support costs by relying more on interservice-type arrangements and outsourcing more base support activities; and finally by (5) reducing training costs by eliminating excess capacity within its training facilities.

New ideas about reducing infrastructure costs have recently been proposed to DOD that focus largely on outsourcing and privatization to achieve savings. Our analysis of CORM, DSB, and OMB Circular A-76 proposals shows that, just as with past initiatives, there is reason for caution about whether the magnitude of hoped for savings can be achieved. Further, the CORM's savings estimates are based primarily on reported savings from public-private competitions under OMB Circular A-76. However, as noted in our work and work done by others, the projected savings from these competitions were not as high as expected. Similarly, the DSB savings projections may be overly optimistic because while they indicate that competition will result in reduced costs, a highly competitive market does not exist in some of the areas being proposed. Lastly, there are various legislative requirements that will also restrict and otherwise affect DOD's ability to implement some proposed initiatives. For example, legislation prohibits the outsourcing of certain functions, such as civilian firefighters or security guards at military installations. Also, there are other provisions that affect the extent to which outsourcing can be accomplished in other areas.

In conclusion, the opportunities for savings are great. However, from what we have seen historically and from our analysis of current initiatives, it is questionable whether the magnitude of hoped for savings will be achieved. Notwithstanding this, we think DOD's effort to reduce costs and achieve savings is extremely important and we encourage DOD to move forward as

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quickly as possible. As we stated in our high-risk infrastructure report, breaking down cultural resistance to change, overcoming service parochialism, and setting forth a clear framework for a reduced defense infrastructure are key to effectively implementing savings. To do this, the Secretary of Defense and the service secretaries need to give greater structure to their efforts by developing an overall strategic plan. The plan needs to establish time frames and identify organizations and personnel responsible for accomplishing fiscal and operational goals. DOD needs to present this plan to the Congress in much the same way it presented its plan for force structure reductions in the Base Force Plan and the bottom-up review. This will provide a basis for the Congress to oversee DOD's plan for infrastructure reductions and will allow the affected parties to see what is going to happen and when.

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## DOD Initiatives Have Achieved Less Savings Than Projected

DOD has initiated several efforts to improve the efficiency and reduce the costs of its support structure since 1990. While DOD has achieved some success, it has not reaped the level of savings expected. Our prior work on several of DOD's major initiatives such as the DMR, the BRAC process, and personnel downsizing illustrates this point and raises some issues the Congress should be aware of as it reviews DOD's current and anticipated infrastructure and support cost reduction initiatives. Despite its initiatives over the past 10 years, DOD's infrastructure and support costs remain about the same, in relative terms, as they were when these initiatives started. In recent testimony before your Committee, one senior Air Force officer noted:

"Our infrastructure was reduced by less than 21 percent after four BRAC rounds, while the force structure fell by 40 percent. This disparity has introduced organizational inefficiencies that drive up O&M costs, making it more difficult for us to give the taxpayers best value for the dollars that we invest in national security . . . . Funding for military construction and real property maintenance by contract has been cut to the bone, and perhaps beyond. We are being pressed hard to find the resources to maintain our mission essential facilities."

Our work has shown that several factors have limited DOD's success in implementing prior initiatives and achieving the expected savings. DOD officials have repeatedly recognized the importance of using resources for the highest priority operational and investment needs rather than maintaining unneeded property, facilities, and overhead. However, DOD has found infrastructure reductions to be difficult and painful because they require up-front investments, the closure of installations, and the

elimination of military and civilian jobs. Service parochialism, a cultural resistance to change, and congressional and public concern about the economic effects on local communities, as well as the fairness of closure decisions, have historically hindered DOD's ability to close or realign bases. DOD has also recognized that streamlining and reengineering its business practices could result in savings, but it has made limited progress in doing so. Many opportunities exist for consolidating and streamlining the services support functions and activities. Unfortunately, DOD has eliminated people and reduced funding without ensuring that the initiatives have achieved the intended efficiencies. In some cases people were reduced without redesigning the function or activity to reduce the staffing needs. While DOD gained some efficiencies through this approach it could have done better by thoroughly and thoughtfully analyzing what work had to be done and where and by whom the work could most cost-effectively be done.

## DMR Savings Are Less Than Projected

The 1989 DMR proposed a program of consolidations and management improvements estimated to save tens of billions of dollars in support and overhead programs and eliminate an estimated 42,900 civilian and military positions over fiscal years 1991-95. The review resulted in 250 decisions to implement consolidations, improve information systems, enhance management, and employ better business practices. The projected savings from each decision ranged from a few million dollars to over \$10 billion. Early in the program, DOD made several adjustments that included reducing savings projections, extending the savings period for 2 years, and identifying additional savings associated with new initiatives. As a result, in April 1992, DOD projected DMR savings to be \$71.1 billion for fiscal years 1991-97 (Air Force, \$22.5 billion; Navy, \$21.6 billion; Army, \$20.9 billion; and DOD agencies, \$6.1 billion). In early 1993, DOD Comptroller officials estimated that changes to the future years defense program (FYDP), force reductions, and workload reductions could result in total savings of about \$62.8 billion rather than \$71.1 billion. The savings reductions, however, could not be tracked to specific DMR initiatives.

In reviewing initial savings estimates, we found that the estimates were not always based on cost analyses supported by historical facts or empirical cost data.<sup>1</sup> During our 1993 review of the DMR we found it difficult to validate and track savings to specific initiatives.<sup>2</sup> Moreover, we

<sup>1</sup>Acquisition Reform: Defense Management Report Savings Initiatives (GAO/NSIAD-91-11, Dec. 4, 1990).

<sup>2</sup>Defense Management Review (NSIAD-94-17R, Oct. 7, 1993).

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could not easily determine the extent to which savings resulted from the initiatives or from other factors such as reduced workloads, changes in force structure, or defense downsizing. For example, one initiative claimed savings of \$5.6 billion for the possible consolidation of supply depots, inventory control points, maintenance depots, automatic data processing design centers and operations, accounting operations and finance centers, and research and development laboratories and test facilities. However, most of these consolidations did not occur. Likewise, an initiative to develop standard and consolidated automated data processing systems throughout DOD was not accomplished. Finally, a DSB task force known as the Odeen panel evaluated the DMR savings projections and concluded there could be a \$12.6-billion to \$16.7-billion shortfall between the DOD's 1992 budget projections for fiscal years 1994-97. The panel also projected additional potential budget shortfalls of \$7.4 billion to \$9.8 billion in fiscal years 1998 and 1999. Overall, it projected an estimated shortfall for the 1994-99 FYDP could be between \$20 billion and \$26.5 billion and that a shortfall existed in operation and maintenance (O&M) funding. We reported in 1994 that the panel's estimated budget shortfall was generally low.<sup>3</sup>

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#### BRAC Savings Are Less Than Projected

Through the BRAC process initiated in 1988, DOD has closed or is closing 97 domestic bases. About 50 percent of the planned closures have been completed. DOD reported that last year, for the first time, the savings from closures exceeded the costs and savings from closures will continue to accumulate each year.

DOD expected its base closures to reduce annual base support costs from \$41 billion in 1988 to \$29.5 billion in 1997. Our analysis of base support costs in the FYDP and at nine closing installations indicates that BRAC savings should be substantial.<sup>4</sup> However, the total amount of actual savings is uncertain because DOD's systems do not provide this information. If DOD BRAC savings are less than estimated, DOD's ability to fund future programs at planned levels will be affected.

DOD has submitted annual BRAC cost and savings estimates, but their usefulness is limited. For example, the Air Force's savings were not based on budget-quality data, and the Army's estimates excluded reduced

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<sup>3</sup>DOD Budget: Evaluation of Defense Science Board Report on Funding Shortfalls (GAO/NSIAD-94-139, Apr. 20, 1994).

<sup>4</sup>Military Bases: Closure and Realignment Savings Are Significant, but Not Easily Quantified (GAO/NSIAD-96-67, Apr. 8, 1996).

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military personnel costs that the Navy and the Air Force included in their estimates. Further, BRAC cost estimates excluded more than \$781 million in economic assistance to local communities as well as other costs. Consequently, the Congress does not have a complete picture of projected BRAC savings.

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## Outsourcing Using OMB Circular A-76 Procedures

For the past three decades, federal agencies have been encouraged to expand their procurements of goods and services from the private sector. For years, DOD has been contracting out functions, activities, and services it formerly accomplished using DOD civilian or military personnel. OMB established procedures for determining whether commercial activities should be outsourced in Circular A-76. These procedures, which have been the primary vehicle used to make these outsourcing decisions, include a handbook for performing cost-effectiveness evaluations. However, these procedures and various provisions of legislation have, to some extent, limited DOD outsourcing and resulting savings.

Using the A-76 process and procedures, DOD has conducted over 2,100 public-private competitions between 1978 and 1994.<sup>5</sup> However, starting in 1988, the number of A-76 studies undertaken each year began to decline substantially. Several legislative provisions limited DOD's outsourcing efforts. For example, the first provision, contained in the National Defense Authorization Act for fiscal years 1988-89 (P.L. 100-180), gave authority to installation commanders to determine whether to study activities for potential outsourcing. Because of disruptions to their workforce, the cost of conducting studies, and a desire for more direct control of their workforce, various officials told us that commanders often chose not to pursue outsourcing. This law, which was known as the "Nichols Amendment" and codified at 10 U.S.C. 2468, was effective through September 30, 1995. Another provision, contained in the DOD Appropriations Act for Fiscal Year 1991 (P.L. 101-511) and subsequent DOD appropriations acts, prohibited funding for lengthy A-76 studies. Finally, a provision contained in the Department of Defense Authorization Acts for Fiscal Years 1993 and 1994 prohibited DOD from entering into contracts resulting from cost studies done under OMB Circular A-76. In response, DOD imposed a moratorium on A-76 studies and canceled about three-quarters of the ongoing studies. The prohibition expired on April 1, 1994, and DOD subsequently lifted the moratorium. These provisions, along with the Nichols Amendment, had the effect of limiting outsourcing in most of the

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<sup>5</sup>DOD maintains a database of those commercial activities that have undergone an A-76 study and the projected savings that were estimated for each.

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services until 1996. In 1996, OMB revised its supplemental handbook in an effort to streamline and improve the outsourcing process.

Fundamental to determining whether or not to outsource is the identification of core functions and activities that DOD should continue to do. OMB Circular A-76 characterizes core as those activities that are "inherently governmental." Under 10 U.S.C. 2464, the Secretary of Defense is required to define DOD's core functions, which are not to be contracted out. DOD has proposed a risk assessment process to be used in identifying core depot maintenance requirements and each of the services is in the process of determining its core requirements using its own procedures. DOD has not defined a core process or identified core requirements for other logistics functions. It is not clear how the process will be used as DOD increases outsourcing using OMB Circular A-76 and other procedures.

The A-76 competitions done through 1994 mostly involved low-skilled work such as commissary operations, family housing and grounds maintenance, administrative and custodial services, and food and guard service. These activities generally involved low capital investment, unskilled labor, and could be defined by relatively simple and straight-forward requirements statements. The competitions generally elicited vigorous competition. About 50 percent of the 2,100 competitions were won by the public sector.

#### Concerns About Projected Savings From A-76 Studies

For various reasons, we are concerned that projected savings of 20 to 40 percent reported from prior A-76 competitions are not reliable. For example, our 1990 evaluation of DOD savings data showed that neither DOD nor OMB had reliable data on which to assess the soundness of savings estimates. Also, DOD and OMB did not know the extent to which expected savings were realized because DOD did not routinely collect and analyze cost information to track savings after a cost study had been done.<sup>6</sup> Further, we have reported that (1) savings estimates represent projected, rather than realized savings; (2) the costs of the competitions were not included; (3) baseline cost estimates are lost over time; (4) actual savings have not been tracked; (5) where audited, projected savings have not been achieved; and (6) in some cases, work contracted out was more expensive than estimated before privatization.<sup>7</sup>

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<sup>6</sup>OMB Circular A-76: DOD's Reported Savings Figures Are Incomplete and Inaccurate (GAO/GGD-90-58, Mar. 15, 1990).

<sup>7</sup>Defense Depot Maintenance: Commission on Roles and Mission's Privatization Assumptions Are Questionable (GAO/NSIAD-96-161, July 15, 1996).

One commercial activity—depot maintenance—has in most cases been exempted from the A-76 process by 10 U.S.C. 2469. However, DOD implemented a similar program for depot maintenance activities beginning in 1985, when the Congress authorized in the DOD Appropriations Act for Fiscal Year 1985 (P.L. 98-473), a test program to allow public and private shipyards to compete for the overhaul of selected ships on the basis of cost comparisons. The program was later expanded to cover Naval aviation, Air Force, and Army depot maintenance. In 1994, DOD terminated its public-private competition program for depot maintenance. We reported that the program had resulted in savings, although these savings were difficult to quantify, and the program should be reinstated.<sup>8</sup> The statement of managers in the conference report on the DOD Appropriations Act for Fiscal Year 1995 provided for the reinstitution of the program, which was accomplished in 1996.<sup>9</sup>

#### Large Personnel Reductions Have Not Resulted in Commensurate Operations and Maintenance Budget Reductions

Since about 40 percent of the O&M budget funds civilian salaries, DOD expects that initiatives to reduce civilian personnel will result in substantial O&M budget reductions. Between 1990 and 1997, DOD has reduced its civilian workforce by 275,000 people—or about 26 percent. Over the same period, the number of active duty service members were reduced by 29 percent and defense-related private sector employees were reduced by 34 percent. Table 1 shows personnel reductions for selected civilian occupational categories. Secretaries and depot maintenance personnel took the largest percentage reduction, at 52 percent and 48 percent, respectively, while educators were reduced by only 5 percent and scientists by 6 percent. Fire and police personnel were reduced by 17 percent and installation maintenance by 20 percent.

<sup>8</sup>Navy Maintenance: Assessment of the Public-Private Competition Program for Depot Maintenance (GAO/NSIAD-96-30, Jan. 22, 1996); Depot Maintenance: Opportunities to Privatize Repair of Military Engines (GAO/NSIAD-96-33, Mar. 5, 1996); and Closing Maintenance Depots: Savings, Workload, and Redistribution Issues (GAO/NSIAD-96-29, Mar. 4, 1996).

<sup>9</sup>H.R. CONF. REP. NO. 103-747.

**Table 1: Changes in Personnel Strengths for DOD and Defense-Related Private Sector Employees**

Numbers in thousands

| Personnel  | FY 1990      | FY 1997      | Reduction  | Reductions in percent |
|--|--------------|--------------|------------|-----------------------|
| Active duty military                                     | 2,143        | 1,521        | 622        | 29                    |
| DOD civilian   | 1,073        | 798          | 275        | 26                    |
| <b>Total</b>   | <b>3,216</b> | <b>2,319</b> | <b>897</b> | <b>28</b>             |
| Defense-related private sector employees                 | 3,150        | 2,080        | 1,070      | 34                    |
| <b>Selected occupational categories of DOD civilians</b> |              |              |            |                       |
| DOD depot maintenance employees                          | 147          | 76           | 71         | 48                    |
| Scientists   | 16           | 15           | 1          | 6                     |
| Data systems managers                                    | 37           | 25           | 12         | 32                    |
| Installation maintenance                                 | 10           | 8            | 2          | 20                    |
| Legal  | 3            | 3            | 0          | 0                     |
| Medical technicians                                      | 10           | 9            | 1          | 10                    |
| Personnel services                                       | 19           | 15           | 4          | 21                    |
| Secretarial  | 69           | 33           | 36         | 52                    |
| Fire and police  | 18           | 15           | 3          | 17                    |
| Educators  | 20           | 19           | 1          | 5                     |

During our review of outsourcing base support operations, various installation commanders told us that one way of achieving across-the-board personnel reductions mandated by the Office of the Secretary of Defense is to outsource, which would free remaining civilian authorizations for use in other activities. One senior command official in the Army stated that the need to reduce civilian positions is greater than the need to save money. This view was reinforced by the DOD Inspector General's 1995 report on cost growth, which noted that "the goal of downsizing the Federal workforce is widely perceived as placing DOD in a position of having to contract for services regardless of what is more desirable and cost effective."

Despite a reduction of 275,000 civilian personnel since 1990, and plans for further substantial reduction over the next several years, our analysis of the 1997-2001 FYDP shows that infrastructure costs are expected to increase. In May 1996, we reported that the infrastructure portion of the 1997 FYDP is projected to increase about \$9 billion, from \$146 billion in 1997 to \$155 billion in 2001 (see table 2).<sup>10</sup> Despite this increase, the

<sup>10</sup>Defense Infrastructure: Budget Estimates for 1996-2001 Offer Little Savings for Modernization (GAO/NSIAD-96-131, Apr. 4, 1996).

infrastructure costs as a proportion of the total budget, is projected to decrease slightly from about 60 percent in 1997 to about 57 percent in 2001. The decrease results primarily because DOD's total budget is projected to increase at a faster rate than the infrastructure part of the budget.<sup>11</sup>

**Table 2: DOD's Projected Funding Through Fiscal Year 2001**

| Dollars in billions |                        |                               |   |
|---------------------|------------------------|-------------------------------|---|
| Fiscal year         | Total projected budget | Infrastructure part of budget | Percentage of budget that is infrastructure |
| 1997                | \$244                  | \$146                         | 60  |
| 1998                | 249                    | 145                           | 58  |
| 1999                | 255                    | 148                           | 58  |
| 2000                | 263                    | 150                           | 57  |
| 2001                | 270                    | 155                           | 57  |

Source: GAO analysis of DOD's 1997-2001 FYDP.

The installation support portion of DOD's infrastructure budget is projected to decline during the 1997 to 2001 period, in part, due to savings generated from the BRAC process. However, other infrastructure categories, including acquisition infrastructure; force management; central logistics; central medical; central training; central personnel; and central command, control, and communications are projected to increase, although individual accounts within these areas, such as military construction and real property maintenance, are declining. The combination of O&M and military personnel appropriations fund about 80 percent of infrastructure activities that can be clearly identified in the FYDP. Thus, DOD must look to these appropriations if it intends to spend less for infrastructure activities.

<sup>11</sup>Defense Infrastructure: Costs Projected to Increase Between 1997 and 2001 (GAO/NSIAD-96-174, May 31, 1996).

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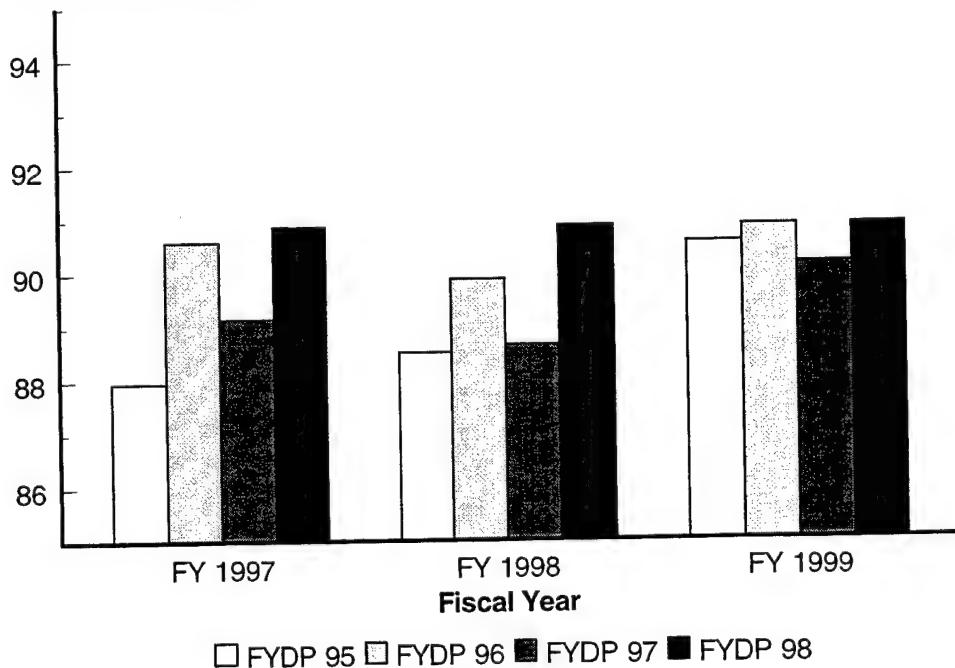
### Shortfalls in Operation and Support Cost Reductions Limit Planned Procurement Fund Increases

Planned reductions in DOD's O&M costs have not achieved expected decreases in the O&M budget. For example, as illustrated in figure 1, although the fiscal year 1995 FYDP projected that O&M funding would be about \$88 billion in fiscal year 1997, the 1997 FYDP estimated that O&M expenditures for fiscal year 1997 would be \$1.2 billion more than projected 2 years earlier. Moreover, the most recent 1998 FYDP estimate shows that about \$92.9 billion will be required to support operations funded by the O&M account during 1997—\$5 billion more than projected by the 1995 FYDP.

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**Figure 1: Operation and Maintenance Spending Estimates for Fiscal Years 1997-99**

**Dollars in billions**

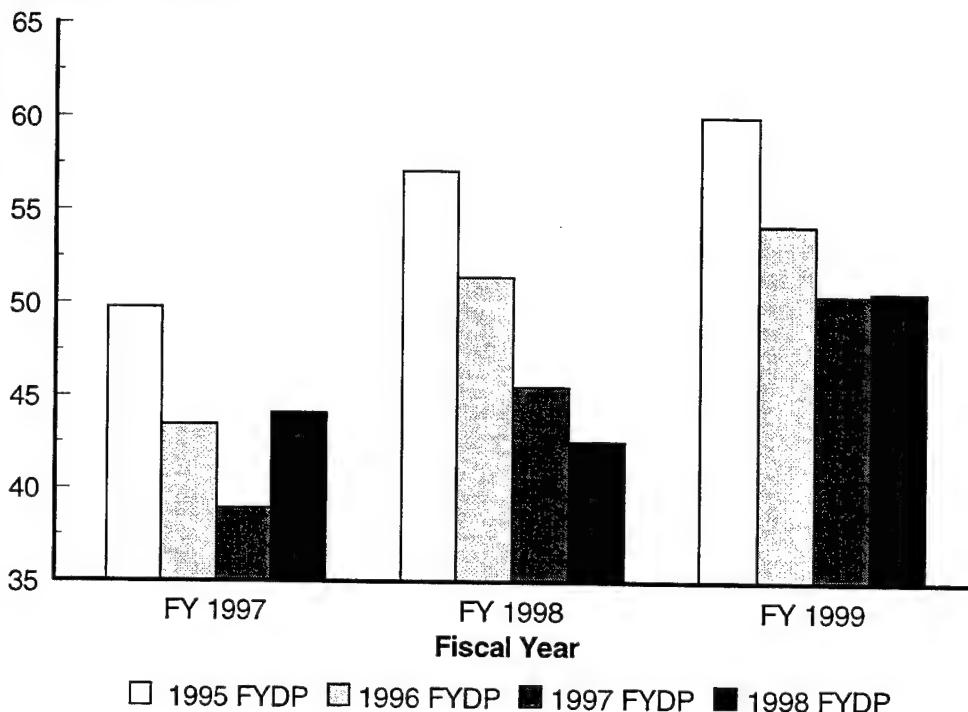


Conversely, as shown in figure 2, the procurement account had to be reduced over that same period to offset increases in O&M cost. Thus, planned DOD increases in procurement funding had to be put aside because of the realities of funding day-to-day operational support costs. For example, the 1995 FYDP projected that DOD would spend \$49.8 billion for procurement in fiscal year 1997. However, DOD actually budgeted only

\$38.9 billion for procurement—over \$10 billion less than projected 2 years earlier. Although the 1998 FYDP indicates that an additional \$5.2 billion was spent for Procurement during 1997 than was budgeted the previous year, the \$44.1 billion expenditure was still \$5.7 less than had been projected in 1995 to be spent for procurement in 1997.

Figure 2: Procurement Spending Estimates for Fiscal Years 1997-99

Dollars in billions



## Opportunities for Achieving Future Infrastructure Savings

As we recently reported, despite DOD's initiatives, it is critical for DOD to further reduce infrastructure and support costs.<sup>12</sup> After 10 years of effort, billions of dollars are still being wasted annually on inefficient and unneeded activities. For fiscal year 1997, DOD estimates that about \$146 billion, or almost two-thirds of its budget, will be for operation and support activities. These activities, which DOD generally refers to as

<sup>12</sup>High-Risk Series: Defense Infrastructure (GAO/HR-97-7, Feb. 1997).

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support infrastructure, include research, development, and procurement of major weapon systems; buying and managing spare parts and repairing equipment; maintaining installation facilities; providing non-unit training to the force; and providing health care to military personnel and their families. Significant excess capacity exists in these activities. While there are many opportunities to reduce this excess capacity and improve the cost-effectiveness of DOD support operations, DOD faces many challenges in doing so. I will briefly highlight some of the key areas where costly excess capacity and infrastructure remain and have the greatest potential for savings—particularly through reengineering and consolidating functions and activities among the services.

- Acquisition infrastructure, which includes activities and personnel that support the research, production, and procurement of weapon systems and other critical defense items, accounts for about \$10.2 billion. We have noted problems in achieving consolidations in testing and evaluation areas and stated that DOD should consider consolidations in two areas—Air Force and Navy electronic warfare threat testing capabilities and high performance fixed-wing aircraft testing capabilities. No major consolidations or reductions have occurred. Likewise, although DOD's laboratories and logistics centers have excess capacity of about 35 percent, prior reform initiatives have generally focused on management efficiencies rather than infrastructure reductions.
- Central logistics, which includes maintenance activities, the management of materials, operation of supply systems, communications, and minor construction, accounts for as much as \$51 billion, including funding from the military revolving funds. We have identified long-standing problems and opportunities to reduce infrastructure costs in the key area of inventory management. While the Defense Logistics Agency has taken steps to reengineer its logistics practices and reduce consumable inventories, it could do more to achieve substantial savings. Further, although DOD has made progress in reducing the value of its secondary inventory, in part by adopting leading edge practices, including use of prime vendor delivery, our analysis of inventory valued at \$67 billion showed that \$41.2 billion of the inventory was not needed. About \$14.6 billion of the unneeded inventory did not have projected demands and will likely not ever be used.<sup>13</sup> Additionally, DOD is currently reassessing the issue of streamlining and consolidating the management of the inventory control points, which are responsible for material management. We have also reported that BRAC recommendations for depot maintenance closures during the 1995 round did little to eliminate excess capacity and

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<sup>13</sup>Defense Logistics: Much of the Inventory Exceeds Current Needs (GAO/NSIAD-97-71, Feb. 28, 1997).

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that excess capacity in the depot system remains at about 50 percent, with the Air Force and the Army having the greatest problems in this area.

- Installation support, which includes personnel and activities that fund, equip, and maintain facilities from which defense forces operate, will consume about \$30 billion, or about 17 percent of the projected fiscal year 1997 infrastructure expenditures. The central issue is that after four BRAC rounds, the services have reduced their facilities infrastructure at a much smaller rate than their force structure. Despite the recognized potential to reduce base operating support costs through greater reliance on interservice-type arrangements, the services have not taken sufficient advantage of available opportunities. Differing service traditions and cultures and concern over losing direct control of support assets have often caused commanders to resist interservicing. Additionally, by having too much infrastructure to support, available military construction and repair dollars are thinly spread.
- Central training infrastructure, which includes basic training for new personnel, aviation and flight training, military academies, officer training corps, other college commissioning programs, and officer and enlisted training schools, will account for about \$19 billion, or 13 percent of projected 1997 infrastructure expenditures. We have identified several training-related installations with relatively low military value that were not proposed for closure, despite the long-term savings potential. We have also pointed out interservicing opportunities that remain.
- Central medical, which includes personnel and funding for medical care provided to military personnel, dependents, and retirees, will account for about \$16 billion of the projected 1997 infrastructure expenditures. Activities include medical training, management of the military health care system, and support of medical installations. Each of the military departments operates its own health care system, even though these systems have many of the same administrative, management, and operational functions. Since 1949, over 22 studies have reviewed the feasibility of creating a health care entity within DOD to centralize management and administration of the three systems—most of them encouraging some form of organizational consolidation.

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## Challenges DOD Faces as It Implements and Considers Proposals to Achieve Infrastructure Savings

Over the last several years, DOD has renewed its efforts to achieve infrastructure savings through the use of the A-76 process. At the same time, studies provided by the CORM and DSB over the last 2 years have provided increasingly aggressive outsourcing proposals and predictions of significant savings. Key elements of the DOD effort and the two studies are:

- DOD anticipates that by 2003 it can achieve over \$2 billion savings annually from outsourcing activities that involve about 130,000 civilian personnel. Further, DOD has reportedly programmed the savings into its fiscal year 1998 FYDP.
- The CORM report issued in May 1995 recommended that DOD outsource or privatize all current and newly established commercial-type support services. The report estimated that taking this action could save over \$3 billion a year.
- The DSB report issued in November 1996 recommended dramatic restructuring of DOD's support structure by maximizing the use of the private sector for almost all support functions. From this and other proposed changes such as the use of better business practices, the DSB estimated over \$30 billion dollars could be saved annually from defense infrastructure accounts by the year 2002.

We agree that substantial savings can be achieved by outsourcing and privatizing; consolidating similar functions to reduce excess capacity; reengineering remaining functions, processes, and organizations; more effectively using technology innovations; and through other initiatives.<sup>14</sup> Our recent report on downsizing the defense infrastructure provides 13 options that could result in savings of about \$11.8 billion from fiscal years 1997 to 2001. However, based on the lessons learned from past initiatives and principally our work on depot maintenance and base support operations, we are concerned that savings of the magnitude projected by DOD, the CORM, and the DSB may not be achievable. Last, as noted by DOD, the CORM, and DSB, a number of legislative requirements restrict or affect implementation of these proposals. The extent to which these requirements change or remain the same will also affect savings estimates.

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<sup>14</sup>Defense Infrastructure: Budget Estimates for 1996-2001 Offer Little Savings for Modernization (GAO/NSIAD-96-131, Apr.4, 1996).

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## Outsourcing Savings Expectations May Not Be Achievable in the Magnitude Projected

In 1993, the National Performance Review endorsed outsourcing, noting that DOD should implement a comprehensive program for outsourcing non-core functions. According to its report, Creating a Government That Works Better & Costs Less, DOD had identified 50 broad area candidates for outsourcing, such as base operations support, housing, health services, maintenance and repair, training, labs, security, and transportation. The report noted that outsourcing should take place when it makes economic and operational sense, based on accomplishing the following steps:

- clearly describe the function in objective terms of what gets done and how its gets done, but not who does it;
- categorize the function as either core or non-core;
- establish detailed, specific performance requirements for each function based on the commander/manager's mission and customer requirements;
- analyze legal, supplier, and performance requirements for each function to determine the source that best balances economic benefits with operational risks;
- produce a detailed performance agreement and associated documents for the function (e.g., performance work statement and request for proposals if the function is to be outsourced); and
- introduce cost competition.

We recently reported that DOD is significantly increasing its emphasis on outsourcing base operation support and other activities through the A-76 process.<sup>15</sup> Our work shows that while opportunities for savings exist, it is questionable whether they will be in the magnitude currently being projected. From October 1995 to January 1997, the services announced plans to begin studies during fiscal years 1996 and 1997 that involve over 34,000 positions, most of which were associated with base support activities. Further studies involving an additional 100,000 positions will be started over the next 6 years. We recognized that outsourcing is cost-effective because the competitions generate savings—usually through a reduction in personnel—whether the competition is won by the government or the private sector. However, we questioned some of the services' savings projections.

After a somewhat slow start in beginning to do A-76 cost studies after reinstitution of the program within DOD, the services are now expanding the A-76 program. One of the reasons is that the services had lost much of the expertise required to define the requirements and conduct the cost

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<sup>15</sup>Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing (GAO/NSIAD-97-86, Mar. 11, 1997).

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evaluations during recent personnel downsizing. The Air Force, which has led the way in initiating new studies, plans to study up to 60,000 positions for potential outsourcing from 1998 through 2003—the majority of which are in base support services. The Army plans to study about 11,000 mostly civilian positions in fiscal year 1997 and another 5,000 from fiscal year 1998 to 2003. The Navy plans to begin studies of about 80,000 positions for potential outsourcing over the next several years—about 50,000 civilians and 30,000 military. Although the Marine Corps estimates it will study about 5,000 positions, it does not have a firm timetable for initiating or completing these studies.

The Air Force projects a 20-percent cost savings of up to \$1.26 billion initially from outsourcing mostly base support functions between 1998 and 2003. The Army projected a 10-percent savings but recently increased its savings projection to 20 percent. The Marine Corps projects initial savings of about \$10 million per year beginning in 1998, increasing to \$110 million per year by fiscal year 2004. The Navy projects a 30-percent net cost savings.

As previously discussed, we have concerns about whether the 20- to 30-percent savings assumed by the services will be achieved. The savings projections are based on unverified projections rather than on actual A-76 savings, and where audited, the estimated savings did not achieve the projections, even though the costs of the competitions were not taken into consideration. Additionally, we recently found that many installation officials expressed concern that personnel downsizing had already eliminated much of the potential for outsourcing to achieve additional personnel savings. Also, potential outsourcing savings may be minimized by increases in the scope of work done under outsourcing. Such increases can occur, when funding becomes available to restore a level of service that had been previously reduced due to resource constraints, such as maintenance and repair activities.

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#### Savings in the Magnitude Projected by the CORM Are Questionable

In its report, Directions for Defense (May 24, 1995), the CORM recommended that DOD outsource all current and newly established commercial-type support services. According to the report, outsourcing candidates should range from routine commercial support services widely available in the private sector to highly specialized support of military weapons. For example, janitorial companies might perform facilities maintenance, replacing government custodians; and commercial software engineering firms might upgrade computer programs for sophisticated

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aircraft electronic countermeasures equipment, replacing government software specialists. CORM's report recommended the following actions:

- Outsource new support requirements, particularly the depot-level logistics support of new and future weapon systems.
- OMB withdraw Circular A-76; the Congress repeal or amend legislative restrictions; and DOD extend to all commercial-type activities a policy of avoiding public-private competition where adequate private sector competition exists.
- Move to a time-phased plan to privatize essentially all existing depot-level maintenance.
- Outsource selected material management activities.
- Increase access to and require enrollment in private sector medical care and require users of DOD care to enroll and DOD to set a fee structure and institute a medical allowance for active duty service members' families.
- Outsource family housing, finance and accounting, data center operations, education and training, and base infrastructure.

The report stated that its recommendations for greater use of private market competition would lower DOD's support costs and improve performance—noting that a 20-percent savings from outsourcing DOD's commercial-type workload would free over \$3 billion per year for higher defense needs.

#### DOD's Response

In response to the CORM report, in 1995 the Deputy Secretary of Defense established integrated policy teams to explore outsourcing opportunities for base support, depot maintenance, material management, education and training, finance and accounting, data processing, and family housing. The teams were expected to identify potential outsourcing candidates, analyze obstacles to outsourcing, and develop solutions to facilitate implementation. In addition, the Secretary established cross-functional teams to recommend changes to OMB Circular A-76 and various legislative provisions that could otherwise delay or impede implementation of newly identified outsourcing initiatives.

The material management team developed business case analyses for outsourcing parts of the Defense Reutilization and Marketing Service and Defense Logistics Agency storage and warehousing operations. The team also identified the Defense Logistics Agency and military inventory control point cataloging function for possible outsourcing. The finance and accounting team identified several potential outsourcing candidates, including claims management, defense commissary bill paying,

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nonappropriated fund accounting, and payroll. One of the cross-functional teams developed a proposed legislative package that called for the Congress to rescind all legislative and administrative provisions constraining outsourcing. This proposal was not adopted. While some outsourcing team meetings are still being held, this effort could be consumed by DOD's current quadrennial defense review, which is likely to identify outsourcing as one of its key initiatives.

### Savings Projections Are Not Well Supported

While recognizing the potential savings from outsourcing, we question the savings projections cited by the CORM. As we reported in July 1996, the CORM's data did not support its depot privatization savings assumption.<sup>16</sup> Half of the competitions were won by the public sector. Further, assumptions were based primarily on reported savings from public-private competitions for commercial activities under OMB Circular A-76. Many private sector firms generally made offers for this work due to the highly competitive nature of the private sector market for these activities, and estimated savings were generally greater if there were a large number of competitors. We also noted that our work and defense audit agencies have reported that projected savings were often not achieved or were less than expected due to cost growth and other factors. Further, the savings resulted from competition rather than from privatization.

Finally, we also noted that outsourcing in the absence of a highly competitive market, would not likely achieve expected savings and could increase the cost of depot maintenance operations. Further, our data shows that outsourcing risks are higher when privatizing unique, highly diverse, and complex work where requirements are difficult to define, large capital investments are required, extensive technical data is involved, and highly skilled and trained personnel are required. CORM assumed that meaningful competition would be generated for most of the work it recommended be privatized. Yet, for depot maintenance, 76 percent of the 240 depot maintenance contracts we reviewed were awarded on a sole-source basis.

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### DSB Projected \$30 Billion Savings Are Questionable

The final report of the DSB in November 1996, Achieving an Innovative Support Structure for 21st Century Military Superiority, recommended a dramatic restructuring of DOD's support structure by maximizing the use of the private sector for almost all support functions. The DSB provided a new vision where DOD would only provide warfighting, direct battlefield

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<sup>16</sup>Defense Depot Maintenance: Commission on Roles and Mission's Privatization Assumptions Are Questionable (GAO/NSIAD-96-161, July 15, 1996).

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support, policy and decision-making, and oversight. All other activities would be done by the private sector—using best practices for achieving better, faster, lower-cost results. The following are examples of changes that might result from DSB's new vision:

- Use the private sector for logistics and maintenance in the continental United States. DOD would get out of the repair and inventory management business. Expand contractor logistics support—the life-cycle support of weapon systems often by the original equipment manufacturers. The report noted that relief from legislative constraints would be required, but that most contractor logistic support could be done without legislative changes. DOD would make an investment of \$300 million to \$500 million for reliability improvements.
- Privatize-in-place testing and evaluation facilities.
- Outsource automatic data processing business to four to six contractor-owned facilities.
- Outsource most DOD finance and accounting service functions.
- Use the private sector to manage DOD housing. Raise allowances and use contractors to build and manage housing where no markets exist.
- Privatize DOD commissaries.
- Privatize all remaining special skills training.
- Privatize all remaining base operating support functions.

DSB's report also advocated revoking OMB Circular A-76. In the meantime, the report suggested avoiding it by recategorizing and getting out of the business of performing various functions, an approach the report noted the Defense Logistics Agency had successfully employed when it transferred the pharmaceutical warehousing and distribution functions to vendors. According to the report, if DOD implemented the specific recommendations of DSB, over \$30 billion could be reduced annually from defense infrastructure accounts by the year 2002. The report used a baseline of \$140 billion for current annual DOD infrastructure costs. These savings were dependent on a reduction of about 5 percent per year in the civilian workforce and about 2 percent per year of military personnel over the next 5 years. The report also recommended a series of base realignment and closure reviews.

#### DSB Savings Assumptions Are Questionable

We have not yet completed our analysis of the DSB report. In general, we agree that there are great opportunities for savings in many of the areas they address. Also, we share their concern that too much excess capacity remains in many of DOD's infrastructure activities. We also believe that outsourcing and the use of leading edge business practices, such as direct

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vendor delivery for inventory, represent opportunities to reduce costs. However, the outsourcing savings projected by this study were based on essentially the same assumptions as those used by the CORM, although the DSB study expanded the functions and activities that it recommended for outsourcing and claimed savings of up to 40 percent from privatization. Our analysis indicates that savings projections of \$30 billion are not likely to be achieved. These savings assumptions were not supported and were based on favorable conditions that may not currently exist for a number of activities recommended for outsourcing. We have found that outsourcing savings are dependent on or highly influenced by (1) the continual existence of a competitive commercial market; (2) the ability to clearly define the tasks to be done and measure performance; (3) the assumption that the private sector can do the required work more cost-effectively than a reengineered DOD activity; (4) the extent that commercial contracting and contract management practices can be applied to the outsourced activity; (5) the relative cost-effectiveness of the public activity being outsourced; and (6) the ability to reduce the existing public infrastructure and personnel costs associated with the outsourced activity. Further, the DSB savings projections may also include functions and activities that are determined to be core.

Another area of concern is that the DSB referred often to outsourcing competitively, yet it recommended total contractor logistics support for weapon systems—often a sole-source arrangement with the original equipment manufacturer—which could include maintenance, supply, systems management, and other functions for the life of the systems. We question whether this is the appropriate model for most weapon systems and are concerned about its potential for cost growth and long-term impact on core capabilities for several reasons:

- First, while DOD managers have found contractor logistics support to be cost-effective for commercially derived systems with established competitive repair sources—these conditions are not present for military unique systems and cutting edge technologies.
- Second, our past work demonstrates that most depot work is sole-sourced to the original equipment manufacturer, raising cost and future competition concerns. DOD managers told us that steadily escalating prices are typical of sole-source contractor logistics support contracts.
- Third, privatizing total support on new and future weapon systems can make it difficult for the organic depots to acquire and sustain technical competence on new systems, leading edge technologies, and critical repair processes necessary to maintain future core capabilities, provide a

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credible competitive repair source, and be a smart buyer for those logistics activities that will be contracted out.

When competition—whether from the private sector or an organic depot—is introduced, prices decline. For example, the Air Force identified \$350 million in savings when it was able to recompete contractor logistics support contracts and move the maintenance work from the manufacturer to other commercial firms, including \$50 million in savings on the KC-10 by awarding a competitive contract to the firm previously subcontracted to the prime, thus cutting out the “middle-man”. The Air Force is also achieving significant savings as a result of interservicing the F404 engine to a Navy depot rather than continuing to contract on a sole-source basis with the original equipment manufacturer as the Air Force did for many years.

Finally, while the DSB report seems to assume that outsourcing is the most cost-effective option for all DOD support operations, this may not be the case. The reengineered public entity was determined to be the most cost-effective for the over 2,100 competitions conducted using A-76 procedures. Further, our review of public-private depot maintenance competitions indicated that the private sector frequently offered the best value.

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#### Effects of Legislation on Outsourcing

A number of legislation provisions may limit outsourcing. For example, section 2464 of title 10 provides that DOD activities should maintain a logistics capability (personnel, equipment, and facilities) sufficient to ensure technical competence and resources necessary for an effective and timely response to a mobilization or other national defense emergency. It also requires the Secretary of Defense to define logistics activities that are necessary to maintain the logistics capability. Those activities may not be contracted out without a waiver by the Secretary. DOD has proposed a risk assessment process to be used in identifying core depot maintenance requirements and each of the services is in the process of determining its core requirements using the procedures each has implemented to do so. DOD has not defined a core process or identified core requirements for other logistics functions. It is not clear how that process will be conducted as DOD increases outsourcing using OMB Circular A-76 and other procedures. Other statutes affecting the privatization of depot

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maintenance are discussed in our March 1996 report addressing opportunities for privatizing repair of military engines.<sup>17</sup>

Also, 10 U.S.C. 2461 requires A-76 cost comparisons, congressional notification of studies involving more than 45 civilians, and annual reports to the Congress on outsourcing. Section 2465 of title 10 prohibits DOD from outsourcing civilian firefighters or security guards at military installations. DOD's fiscal year 1996 inventory of civilian and military personnel performing commercial activities shows that about 9,600 firefighters and 16,000 security guards are exempt from outsourcing because of this law and other considerations, such as mobility requirements. Outsourcing is permitted only if the positions were outsourced before September 24, 1983. We plan to assess this issue more thoroughly by comparing the cost of in-house positions in selected instances where such services have been outsourced.

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## Conclusions

In conclusion, we agree with DOD that its infrastructure costs can and should be substantially reduced, and we believe that DOD should identify key functions and activities where it should focus to identify requirements—including core—and begin to reengineer those activities and functional areas that appear to offer the best opportunities for savings. Outsourcing, when used correctly, has been an effective tool in achieving cost reductions. Our work advocates expanded reliance on the private sector where that is the most cost-effective solution. However, evaluations must be made on an individual basis, taking into consideration the costs and benefits of each potential outsourcing opportunity.

DOD already has programs to identify potential infrastructure reductions in many areas. However, breaking down cultural resistance to change, overcoming service parochialism, making decisions to eliminate cross functional stovepipes, and setting forth a clear framework for a reduced defense infrastructure are key to avoiding waste and inefficiency and generating the maximum savings from DOD's infrastructure accounts. To do this, the Secretary of Defense and the service secretaries need to give greater structure to their efforts by developing an overall strategic plan that establishes time frames and identifies organizations and personnel responsible for accomplishing fiscal and operational goals. DOD needs to present this plan to the Congress in much the same way that it presented its plans for force structure reductions in the Base Force Plan and

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<sup>17</sup>Depot Maintenance: Opportunities to Privatize Repair of Military Engines (GAO/NSIAD-96-33, Mar. 5, 1996).

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bottom-up review. The Congress can then oversee the plan and allow the affected parties to see what is going to happen, and when. In developing the plan, DOD should consider using a variety of means to achieve reductions, including consolidations, reengineering, interservicing agreements, and outsourcing—with appropriate personnel reductions implemented to take advantage of the efficiencies generated by these initiatives. It should also consider the need and timing for future BRAC rounds, as suggested by the 1995 BRAC Commission and other groups.

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Mr. Chairman, this concludes my prepared remarks. I would be pleased to answer questions at this time.

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